ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Sen. Rev. & Tax. Comm. | Analyst: Jeani Brent | Bill Number: SB 2234

Related Bills: See Legislative History | Telephone: 845-3410 | Amended Date: 07/01/98

Attorney: Doug Bramhall | Sponsor: Franchise Tax Board

SUBJECT: AB 3086 Clean-up/ Alimony Deduction/Excess SDI/Federal Adjs./AMT Depreciation/Technical Credit Repeal Language/LARZ NOL

X DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of bill as amended April 13, 1998.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended __________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED March 3, 1998, and as AMENDED April 13, 1998, STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

This bill, sponsored by the Franchise Tax Board, would make the following changes:

1. Clarify the Unemployment Insurance Code (UIC) requirement amended by AB 3086 (Stats. 1994, Ch. 1049) regarding which amounts must be included in the Report of Wages by specifically including amounts withheld from pensions, annuities, and other forms of deferred compensation.

2. Provide that nonresidents prorate the deduction for alimony payments in the same manner as the nonresident tax is prorated.

3. Retain the program to refund excess state disability insurance through the tax return while ensuring that taxpayers who fail to claim the credit on their return still would be identified as quickly as possible to receive a refund of their excess contributions.

4. Make several changes relating to federal adjustments regarding defining the final federal determination date and requirements for taxpayers to notify the department of any federal changes to their tax return.

5. Make a technical correction to the alternative minimum tax (AMT) provisions to refer to the depreciation provisions under the Bank and Corporation Tax Law (B&CTL) rather than those under the Internal Revenue Code (IRC).

Board Position:			Department Director	Date
X S	___ NA	___ NP		
___ SA	___ O	___ NAR		
___ N	___ OUA	___ PENDING	Gerald H. Goldberg	7/21/98

6. Make nonsubstantive technical changes to various credits by eliminating redundant language regarding the carryover of repealed or inoperative credits.

7. Correct a chaptering error by reinstating the December 1, 1998, sunset date of the Los Angeles Revitalization Zone (LARZ) net operating loss (NOL) as enacted by AB 18 (Stats. 1993, Ch. 18).

The July 1, 1998, amendments added the provisions identified as #5, #6, and #7 above, which will be discussed separately in this analysis, and removed provisions relating to the technical change to the limited liability company suspension rules and a provision relating to the removal of the commercial domicile restriction. The discussion of item #1 above in the department's analysis of the bill as introduced still applies and the discussion of items #2, #3, and #4 in the department's analysis of the bill as amended April 13, 1998, still applies.

REVENUE ESTIMATE

Based on data and assumptions discussed below, revenue losses from this bill are estimated to be as follows:

Estimated Revenue Impact of SB 2234 As Amended July 1, 1998 (In $Millions)				
		1998/99	1999/00	2000/01
1.	Unemployment Insurance/AB 3086 Clean-Up	*	*	*
2.	Nonresident Alimony Deduction	($5)	($2)	($2)
3.	Excess state disability insurance refunds	*	*	*
4.	Corrected Tax Return/Fed. Determinations	*	*	*
5.	AMT Depreciation Technical	*	*	*
6.	Credits/Eliminate Redundant Language	*	*	*
7.	LARZ Net Operating Loss	*	*	*

Note: * = No revenue impact

BOARD POSITION

Support.

The Franchise Tax Board voted at its November 17, 1997, meeting to sponsor the language in this bill identified as issue #1, relating to AB 3086 cleanup, issue #5 relating to AMT depreciation, and issue #6, relating to eliminating redundant credit language and issue #7, relating to changing the LARZ net operating loss cease operative date.

The Franchise Tax Board voted at its March 26, 1998, meeting to sponsor the language in this bill identified as issue #2, relating to the deduction for nonresident alimony payments, and issue #3, relating to excess state disability insurance refunds.

The Franchise Tax Board voted at its February 4, 1998, meeting to sponsor the language in this bill identified as issue #4, relating to federal adjustments.

ISSUE #5: Alternative Minimum Tax Depreciation

EFFECTIVE DATE

This provision would apply to taxable or income years beginning on or after January 1, 1999.

BACKGROUND

In 1987, California enacted legislation that established AMT in lieu of the previous tax on preference income. The California legislation substantially conformed state law to the AMT provisions adopted at the federal level as part of the Tax Reform Act of 1986. The AMT at both the federal and state levels was established to ensure that no taxpayers with substantial economic income could avoid all tax liability by using exclusions, deductions, and credits (tax preference items).

SPECIFIC FINDINGS

Existing state and federal laws generally allow as a depreciation deduction a reasonable allowance for the exhaustion, wear, tear, and obsolescence of property used in a trade or business or property held for the production of income.

Existing federal law uses the Modified Accelerated Cost Recovery System (MACRS) for property placed in service after 1986. Under MACRS, the depreciation deduction is computed using the “applicable depreciation method,” the “applicable recovery period,” and the “applicable convention.” MACRS provides three applicable depreciation methods: 200% declining balance, 150% declining balance, and straight-line. The applicable recovery period ranges from three to 50 years, depending on the type of property. The applicable convention requires that property placed in service be treated as being placed in service on the mid-point of either the taxable year (half-year convention), the month (mid-month convention), or the quarter (mid-quarter convention).

Existing federal law provides an alternative depreciation system (ADS), which provides generally longer recovery periods than the standard MACRS and requires the straight-line depreciation method. Six types of property are subject to ADS.

Existing federal law requires that taxpayers subject to AMT compute depreciation differently for AMT than for regular tax. For most depreciable real property and property depreciated under the straight-line method for purposes of the regular tax, AMT depreciation is computed under ADS. For all other property, AMT depreciation is computed under ADS except that the 150% declining balance method is substituted for straight-line depreciation (switching to straight-line in the year necessary to maximize the allowance). This 150% declining balance method is not allowed if the straight-line method was used for regular tax purposes. This restriction prevents the possibility of AMT depreciation being greater than regular tax depreciation.

Existing state law provides that, with respect to reading state law that is conformed to federal law, due account be made for differences in federal and state terminology, effective dates, substitutions of income for taxable year, and other obvious differences. **Existing state law** also provides that any reference to a specific provision of the IRC shall include any modifications of that provision.

Existing state PITL generally conforms to the federal MACRS, uniform capitalization rules, and to the federal AMT depreciation rules.

Existing state B&CTL does not conform to the federal MACRS or ADS. Instead, property must be depreciated over its estimated useful life, which is the period over which the asset reasonably may be expected to be useful in the trade or business. Taxpayers may elect to use the useful life specified under the federal class life Asset Depreciation Range system (ADR). ADR groups assets into more than 100 classes and assigns an asset guideline period, or useful life, to each class.

Existing B&CTL conforms to the federal AMT depreciation. The B&CTL provisions, by conformity, refer to depreciation computed under IRC sections 167 and 168 for regular tax purposes. Since regular tax computations under the B&CTL do not utilize the federal depreciation rules of IRC Sections 167 and 168, the California rules are inconsistent with the depreciation rules for corporations for regular tax purposes.

This bill would replace the references to federal law for California AMT purposes with references to the depreciation provisions under the B&CTL.

Policy Consideration

Clarifying references aids the administration of the law by alleviating any potential confusion that may otherwise occur.

Implementation Consideration

Implementing this provision would not affect the department's programs and operations.

FISCAL IMPACT

Departmental Costs

No departmental costs are associated with this provision.

Tax Revenue Estimate

This provision would not impact state tax revenue.

ISSUE #6: Credits: Delete Redundant Language

EFFECTIVE DATE

This provision would apply to taxable or income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 802 (Ch. 1352, Stats. 1989)

SPECIFIC FINDINGS

The Revenue and Taxation Code (R&TC) provides general rules which apply to all income and franchise tax credits, unless the individual credit provisions specify otherwise. These general rules include the rule that any remaining credit carryover allowed by a section that has been repealed or made inoperative may be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

The general rules were first enacted in 1989 to simplify the administration of tax credits by eliminating the need for each credit to provide for the treatment of excess credit carryover. Seven personal income tax credits and seven bank and corporation tax credits contain carryover language (where the underlying credit statute has been repealed) that is unnecessary and duplicative of the general provision.

This bill would delete redundant repeal language in existing credits.

Policy Considerations

This provision would eliminate redundant language making the law easier to administer and reducing any potential confusion that may otherwise occur.

Implementation Considerations

This provision would not impact the department’s programs or operations.

FISCAL IMPACT

Departmental Costs

This provision would not impact the department’s costs.

Tax Revenue Estimate

This provision would not impact state income tax revenue.

ISSUE #7: LARZ Net Operating Loss

EFFECTIVE DATE

This provision would apply to taxable or income years ending after December 31, 1997, to ensure that the statute is available to all 1997 fiscal year taxpayers.

LEGISLATIVE HISTORY

AB 18 (Stats. 1993, Ch. 18), AB 693 (Stats. 1993, Ch. 1216); AB 38 (Stats. 1992, Ch. 17x)

PROGRAM HISTORY/BACKGROUND

Assembly Bill 38 (Stats. 1992, Ch. 17x), which enacted the LARZ and its tax incentives, provided sunset dates for all the tax incentives of January 1, 1998. To ensure that the tax incentive statutes remained on the books for all 1997 fiscal years, clean-up legislation (AB 18, Stats. 1993, Ch. 18), enacted in May 1993, changed the sunset dates for the tax incentives to December 1, 1998. However, later that year, AB 693 (Stats. 1993, Ch. 1216), which enacted the LAMBRA provisions, unintentionally chaptered out the change to the sunset date for the LARZ NOL. This chaptering out occurred because NOL provisions for all economic development areas are contained as subdivisions of the same code section. When AB 693 added another paragraph for LAMBRAs, it did not contain the same changes to the LARZ subdivision as were contained in AB 18 earlier that year. Instead, it reenacted the provisions of the LARZ subdivision that had been amended by AB 18. Until recently, this problem went unnoticed. All other LARZ tax incentive provisions contain the December 1, 1998, sunset date because each is contained in a separate code section and neither AB 693, nor any other bill passed that year, contained changes to those sections. Thus, the LARZ NOL is the only LARZ tax incentive provision with a January 1, 1998, sunset date.

SPECIFIC FINDINGS

Under the Government Code, existing state law provides for the designation of five types of economic development areas (EDAs): enterprise zones, the Los Angeles Revitalization Zone (LARZ), Local Agency Military Base Recovery Areas (LAMBRA), Targeted Tax Area (TTA), and Manufacturing Enhancement Areas (MEA). Using specified criteria, the Trade and Commerce Agency (TCA) designates EDAs based on applications (maps in the case of the LARZ) received from the governing bodies. Enterprise zones are designated for 15 years, and TCA has designated each of the 39 enterprise zones authorized under existing law. The LARZ was designated in 1992 and is binding for five years. Five LAMBRA designations are authorized, one from each of the five regions (as specified) of the state. Currently, TCA has designated two of the five LAMBRAs authorized under existing law, and the other three areas have received conditional designation. Each LAMBRA designation is binding for eight years. The TTA designation is binding for 15 years, beginning January 1, 1998. Two MEAs are authorized and the designation is binding for 15 years, beginning January 1, 1998.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within EDAs. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss (NOL) treatment. Two additional incentives are a net interest deduction for businesses that make loans to businesses within the economic development areas (not available for LAMBRAs, TTA, or MEA) and a tax credit only for employees working in an enterprise zone. Businesses that operate in MEAs are eligible only for a hiring credit.

The special net operating loss treatment allows a business located in an economic development area to elect to carry over 100% of the economic development area net operating losses (NOLs) to deduct from economic development area income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the economic development area.

Under the Revenue and Taxation Code, existing state law provides that a "fiscal year" is any accounting period of 12 months that ends on the last day of any month other than December. Any accounting period ending in December is a "calendar year."

This bill would correct a chaptering error by reinstating the December 1, 1998, sunset date of the LARZ net operating loss as enacted by AB 18 (Stats. 1993, Ch. 18).

Policy Considerations

Reinstating the LARZ NOL December 1, 1998, sunset date would clarify that the statute remains operative for all 1997 fiscal year taxpayers.

Implementation Considerations

Implementing this provision would not affect the department's programs and operations.

FISCAL IMPACT

Departmental Costs

No departmental costs are associated with this provision.

Tax Revenue Estimate

This provision would not impact the state's income tax revenue.